ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Robert Pacheco | Analyst: Kristina North | Bill Number: AB 53

Related Bills: None | Telephone: 845-6978 | Introduced Date: 12/07/98

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Personal Exemption Credit For Child/Allow Custodial & Noncustodial Parents To Claim Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow both custodial and noncustodial parents to claim a personal exemption credit for the same child under certain conditions.

EFFECTIVE DATE

This bill would be effective immediately upon enactment and apply to taxable years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

Existing federal law provides personal exemptions for an individual, his or her spouse and dependents subject to certain income limitations. These exemptions are treated as deductions from adjusted gross income (AGI). The exemption amount is indexed annually for inflation and is $2,642 for the 1998 tax year. Exemption deductions begin to phase out at federal AGI levels over specified amounts, which are the same amounts as those for state law noted below.

Existing federal law provides that the parent having “custody” of the child for a greater portion of the calendar year is the "custodial parent" and would generally be entitled to the personal exemption for the dependent child. If the custodial parent signs a written declaration that he or she will not claim the exemption for any taxable year, the noncustodial parent is entitled to the exemption.

The federal Taxpayer Relief Act of 1997 (TRA of 1997) provided a child tax credit of $400 for 1998 and $500 for 1999 and each year thereafter for each qualifying child. “Qualifying child” is defined as any individual (1) for whom the taxpayer is allowed the exemption deduction, (2) who is under the age of 17, and (3) who bears the same relationship to the taxpayer as that required under the relationship test for the federal earned income credit. The “qualifying child” must be a citizen, national, or resident of the United States. This child tax credit is phased out for taxpayers with adjusted gross income above specified levels. For taxpayers with three or more qualifying children, the credit is limited to the greater of (1) the excess of regular tax over tentative minimum tax, or (2) the alternative credit amount, as defined. Any credit amount in excess of these limitations, reduced by the amount of alternative minimum tax paid, will be refunded to the taxpayer.

Board Position:			Department Director	Date
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______ N	______ OUA	___X___ PENDING	**Gerald Goldberg**	**2/24/1999**

Existing state law provides various exemption credits, including a personal exemption credit based on filing status, and an additional personal exemption credit for the blind and for individuals 65 or older. Unlike federal law, these personal exemptions are not deductions from AGI but are credits against tax. The personal exemption credit amount is indexed annually for inflation and is $70 for the 1998 tax year. To compute personal exemption credits, the total number of personal exemptions claimed is multiplied by the exemption credit amount (total number of exemptions x $70 = exemption credit). Personal exemption credits are not refundable and may not be carried over to future years.

Current state law allows a personal exemption credit for each dependent for whom an exemption is allowable under federal law. The exemption credit for a dependent is $253 for 1998 and $227 for 1999 and is indexed annually for inflation beginning in tax year 2000. These dependent exemptions are not deductions from AGI, but are credits against tax. The state dependent exemption credit differs from the federal child tax credit in amount ($400 federal in 1998 versus $253 state in 1998). It also is broader in that the qualifying dependent definition for state purposes is not limited to children under age 17 who meet the relationship test under the earned income credit rules but allows all dependents to qualify.

Current state law also allows a unique joint custody head of household credit in an amount equal to 30% of net tax (not to exceed $281 for 1998) to an individual who is:

1) not married at the close of the taxable year, or files a separate return and whose spouse is not a member of the individual's household during the entire taxable year;

2) maintains as his or her home a household which constitutes for the taxable year the principal place of abode for a qualifying child for no less than 146 days of the taxable year, but no more than 219 days of the taxable year under a decree of dissolution or separate maintenance, or under a written agreement between the parents prior to the issuance of a decree of dissolution or separate maintenance where the proceedings have been initiated;

3) furnishes over one-half the cost of maintaining the household during the taxable year; and

(4) does not qualify for head of household or surviving spouse filing status under state tax law.

Existing state law provides two limitations on exemption credits:

1. Exemption credits begin to phase out at federal AGI levels over the amounts listed below:

Filing Status	AGI (1998)
Single/Married Filing Separate	$116,777
Head of Household	$175,166
Married Filing Joint	$233,556

2. Exemption credits are limited to the amount by which regular tax before credits exceeds tentative minimum tax (TMT).

This bill would allow the noncustodial parent of a child to claim a personal exemption credit for that child if that parent pays all court-ordered child support by December 31st of the year for which the child support is due. Child is defined by reference to federal law as the taxpayer's son, stepson, daughter, or stepdaughter.

This bill would allow the custodial parent to also claim a dependent exemption credit for that child if the child resides with the custodial parent for at least 50% or more of the taxable year.

This bill would require courts to consider the credits allowed by this bill when determining child support.

Policy Considerations

Existing state tax law currently provides a joint custody head of household credit providing an amount equal to 30% of net tax (not to exceed $281 in 1998). Depending on the circumstances, the noncustodial parent may be able to claim both the joint custody head of household credit and the personal exemption credit allowed under this bill.

This credit requires that the taxpayer pay child support ordered by a court, excluding those taxpayers making voluntary child support payments.

Implementation Considerations

Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill allows the exemption credit to the custodial parent if the child resides with the custodial parent "at least 50% or more of a taxable year." This provision changes California law, which conforms to federal law, for residency requirements for a custodial parent claiming the exemption credit. If the author does not intend to modify state law for the custodial parent, all of subparagraph B of paragraph 3 can be deleted so that the custodial parent will be entitled to the exemption credit under current law, and this new credit will be allowed in addition to the existing credit.

This bill allows an exemption credit if a parent pays, by December 31 of the year in which it is owed, all child support ordered by a court. However, it should be specified whether "all child support ordered by a court" would include both current year and all prior year child support owed.

Further, if a taxpayer owes child support for more than one child (by different mothers) and is current for one child, but not current for another child, it is unclear if the taxpayer would be allowed to claim an exemption for the child for which the support payments are current.

Technical Considerations

It is unclear why the bill includes a reference to IRC section 152(e). Except for using this IRC section's definition of "dependents" for the state personal exemption credit, the Revenue and Taxation Code (R&TC) is not conformed to this IRC section. This reference is confusing and should be deleted.

This bill would establish, in the R&TC, a requirement for courts to consider the credits allowed by this bill when determining child support. For public convenience, the author may wish to consider placing this requirement in the Family Code.

FISCAL IMPACT

Departmental Costs

If the implementation concerns are resolved, this bill should not significantly impact the department's costs.

Tax Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of AB 53			
For Taxable Years Beginning 1/01/99			
Assumed Enactment After 6/30/99			
Fiscal Years			
(In Millions)			
1999/2000	**2000/01**	**2001/02**	**2002/03**
($180)	($180)	($185)	($190)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

This provision is not anticipated to have a significant impact on taxpayer behavior, due to the relatively low incomes of the obligors and the average delinquency value, estimated to be approximately $10,000. This minor incentive (less than $500,000 annually in additional credits) does not affect the rounded estimates above.

Tax Revenue Discussion

The impact of this bill would depend upon the number of individuals claiming the credit and the average credit applied against tax liabilities.

The estimated revenue losses were determined in the following steps:

First, it was assumed that qualifying individuals must be current for all prior year and current year child support obligations, and all support orders must be paid by December 31 of the tax year for which the credit is claimed.

Second, the total number of individuals qualifying for the credit was based on information from the California Department of Social Services (DSS) and the U.S. Statistical Abstract. According to the above sources:

- District Attorney's offices (DA) handle more than two million child support cases. Of this total, approximately 50% (1 million) of the cases have support orders.
- The DA handles approximately 58% of all cases with support orders.
- For those court-ordered support cases handled by DAs, approximately 22% (226,000) of all obligors are current (all court-ordered child support is paid in full with no arrearages) with their child support payment. This was based on a characteristic survey on the social and economic characteristics of families receiving child support enforcement services prepared by DSS and other data available from DSS.
- The average number of dependents per case is approximately 1.5.
- For those cases not handled through DAs, it is estimated that approximately 415,000 obligors are current with their child support payment. This assumption was based on information from the U.S. Statistical Abstract and DSS.
- The average income for obligors is estimated to be $30,000 ($25,000 for cases handled through DAs and $35,000 for non-DA cases). This average was based on information from DSS and a study conducted by the Judicial Council on child support cases in which an order was entered.
- The average credit for 1999 is estimated to be $329 per claimant.
- Based on information from the department's personal income tax model, and adjusting for the recently enacted renters credit, 84% of the credit is estimated to reduce available tax liabilities.

Therefore, under this bill, approximately 641,000 individuals would claim the credit for a revenue loss of approximately $180 million [641,000 claimants x $276 applied credit ($329 average credit x 84% applied = $276)].

BOARD POSITION

Pending.